



STATE BOARD OF EQUALIZATION

LEGAL DIVISION (MIC:82)
450 N STREET, SACRAMENTO, CALIFORNIA
(P.O. BOX 942879, SACRAMENTO, CALIFORNIA 94279-0001)
(916) 324-2634

MEMBER
First District

BRAD SHERMAN
Second District, Los Angeles

ERNEST J. DRONENBURG, JR.
Third District, San Diego

MATTHEW K. FONG
Fourth District, Los Angeles

GRAY DAVIS
Controller, Sacramento

August 4, 1994

BURTON W. OLIVER
Executive Director

D--- J---
XXXX --- --- XX
Suite XXX
---, TX XXXXX

Dear Mr. J---:

I am writing in response to your letter dated June 9, 1994 to Mr. Glenn Rigby of the Franchise Tax Board concerning the tax status in California of your client, L---, Inc. (L---). Mr. Rigby forwarded your letter to us for response concerning the Sales and Use Tax Law, since the Board of Equalization administers that law in California.

You write that L--- is a Texas corporation which primarily creates and markets computer software that includes proprietary oil and gas production information. The information is incorporated into a CD-Rom, along with software allowing access to the data. You state that the software is licensed to the purchaser and L--- retains the right to the proprietary data and the CD-Rom which contains the data. The purchaser/licensee is required to return the CD-Rom if it violates any prohibitions contained in the licensing agreement. You also indicate that the data is updated monthly and that a customer may subscribe to the updates by returning the original CD-Rom and receiving an updated one. You state that "[i]n short, L--- retains interest in the CD-Rom and the associated software. This might constitute a lease of the data, especially since L--- provides monthly updates on a subscription basis." You have not provided a copy of the agreement between L--- and its customer.

You also indicate that L--- will assist a purchaser in obtaining and setting up any necessary computer equipment, even if this means a purchase by L--- and resale to the customer. You indicate that although this has not occurred in California, it is possible that it will in the future.

You state that L--- has advertised the software in a national publication and that orders were received from several states, including California. You state that all orders have been taken over the telephone, and all deliveries have been made by mail. You further state that L--- has no office or sales force in California, and has never sent an employee or officer into California, nor has any plan to do so. I assume this relates to all of L---'s operations.

You ask how California taxes apply to L---.

Discussion:

Initially, I note that some of the most important facts pertaining to your inquiry are included in L---'s contract with its customer, which you have not made available to us. However, we will provide you with a discussion of the general rules applicable to your transactions as we understand them from your description.

Under the California Sales and Use Tax Law, sales tax is imposed on a retailer's gross receipts from retail sales of tangible personal property occurring in California, unless the sale is otherwise excluded or exempted by statute. (Rev. & Tax. Code § 6051.) "Retailer" includes every seller who makes retail sales of tangible personal property. (Rev. & Tax. Code § 6015(a)(1).) "Tangible personal property" includes storage media, such as CD-Roms, on which prewritten computer programs are transferred to customers. (See Reg. 1502(f)(1).)

When sales tax is not applicable to a sale of tangible personal property (e.g., the sale occurs outside of California), use of the property in California is subject to use tax if the property was purchased from a retailer for use in California. (Rev. & Tax. Code §§ 6201, 6401.) Although the use tax is owed by the purchaser, any retailer who is engaged in business in California must collect the use tax from the purchaser and pay it to the Board of Equalization. (Rev. & Tax. Code § 6203.) However, to be defined as a retailer engaged in business in California, the retailer must have some kind of presence in this state such as a physical location, a representative or agent in California, tangible personal property situated in this state from which rentals are derived, or any other presence as listed in Revenue and Taxation Code section 6203.

In other words, if L--- makes a retail sale in California, as the retailer it owes and must remit sales tax on that sale to the Board. Even if the sale is not made in California, if L--- is a retailer engaged in business in California, L--- must collect and remit to the Board use tax from its California customers who purchase tangible personal property from L--- for use in California. On the other hand, if L--- is not a retailer engaged in business in this state within the meaning of section 6203, it would not be required to collect the use tax. (We have insufficient information to reach a conclusion on whether L--- has any presence in California within the meaning of section 6203.) However, L---'s California customers will still owe use tax on their use of tangible personal property which they purchase from L--- for storage, use, or consumption in California.

In such an instance, to make the payment of this tax more convenient for its customers, L--- may chose to voluntarily register with the Board and collect and remit the use tax which its California customers owe to the Board. (See Reg. 1684(b).) If L--- does so, it will be required to collect all use taxes due with respect to its sales to California consumers.

A lease or a hiring of property is a contract by which one gives temporary possession and use of the property to another, and the latter agrees to return the property at a future time. (Civ. Code § 1925.) Therefore, if L---'s customer is required to return the CD-Rom at some future time, the agreement is a lease, not an outright sale. Under the Sales and Use Tax Law, a lease of tangible personal property is regarded as a continuing sale of the property unless the lessor leases the property in substantially the same form as acquired and California sales tax reimbursement or use tax was timely paid measured by the purchase price of the property. (Rev. & Tax. Code § 6006(g)(5), 6006.1; Reg. 1660(b).) However, according to your letter, since L--- incorporates the programs and data onto the CD-Rom, the property cannot be leased in the same form as acquired by L---. The tax on a lease which is a continuing sale is a use tax owed by the lessee, which is measured by the rentals payable on the lease. The lessor is required to collect the tax from the lessee and pay it to the Board of Equalization. (Reg. 1660(c)(1).)

As noted above, a lessor is a retailer engaged in business in this state with respect to a lease of tangible personal property in this state. (Rev. & Tax. Code § 6203(c).) If the CD-Rom must be returned to L--- at some future time, the transaction is a lease of tangible personal property situated in this state. Since the leased property would be situated in California, L--- would be a retailer engaged in business in this state with respect to that lease and would be required to collect use tax measured by the rentals (including any charges for a license to use the information (see BTLG Annot. 330.2890 (11/12/74)) and any subscription charges) and pay it to the Board.

As to any purchases of computer equipment by L--- and resale of that equipment to a California customer, if L--- is engaged in business in California within the meaning of Revenue and Taxation Codes section 6203 or if it voluntarily registers in California to collect and remit use tax from its California customers, then it is required to collect use tax on its sales of tangible personal property, such as computers, made outside of California to California consumers. If L--- is not engaged in business in California, such sales to California consumers remain subject to use tax, but the California consumer would be required to self report that use tax. If L--- were to lease computer equipment to California consumers, the rules discussed above for leases of CD-Roms would apply. That is, if L--- leases computer equipment to California consumers and does not timely pay California sales tax reimbursement or California use tax, L--- must collect use tax from its lessees measured by rentals payable and remit it to this Board.

D--- J---

-4-

August 4, 1994
330.2318

I hope this information is of assistance to you. Please write again if we may be of further help. If you do so, please include copies of all relevant contracts (e.g., software and computer equipment contracts).

Sincerely,

Sharon Jarvis
Staff Counsel

SJ:es

cc: OH - District Administrator